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Sunil Mangwani discusses various approaches to using Pivot Point analysis in trading Forex. Pivot Point calculations use data from the previous bar to find support and resistance levels to be used in short-term analysis.

The Pivot Point System

Since the values are calculated from the numerical averages of the high, low and closing prices of a financial instrument, the Pivot Point System can be classified as a technical indicator. The Pivot Point System can also be classified as a technique to help ascertain where the price is relative to previous market action. In a very basic sense, it can be defined as a turning point.

A look at market movement shows that price fluctuates between levels of support and levels of resistance. Properly identifying key support and resistance levels can improve the ability to enter, exit and manage market positions. Hence, it becomes beneficial to have a map to see where price is relative to previous market action. With this tool, the sentiment of traders and investors can be seen at any given moment and a general idea of market direction can be determined during the day.

Thus, the Pivot Point can tell us where the sentiment of traders and investors changes from bull to bear or vice versa.

The main advantage of the Pivot Point technique is that it is price-based rather than indicator-based. By the time most indicators generate an entry signal, the move is already well under way. By following this system, one can enter trades before the indicator-following traders and be well into a trend when the signals are being generated on stochastic indicators or other oscillators.

One may ask, why do the Pivot Points work?

Pivot Points work best on highly liquid markets, like the spot currency market, but they can be used in other markets as well.

They work simply because many individual and institutional traders and investors use and trust them. It is known to every trader that the Pivot Point is an important measure of strength and weakness of any market.

Trading with Pivot Points is not a big secret. Floor traders and dealing desks have been applying the methodology in the financial markets for decades. But what separates the profitable traders from

Condition	Calculation	Tomorrow's Projections
Today's Close < Today's Open	Today's high + today's low + today's close + today's low = X	High = X/2 – today's low Low = X/2 – today's high
Today's Close > Today's Open	Today's high + today's low + today's close + today's high = X	High = X/2 – today's low Low = X/2 – today's high
Today's Close = Today's Open	Today's high + today's low + today's close + today's close = X	High = X/2 – today's low Low = X/2 – today's high

the losers is the simple act of following the trend of the day, cutting losses short and letting profits run to the next Pivot value.

There are several different methods for calculating Pivot Points – the most common is the 5-point system.

This system uses the high, low and close to derive the Pivot Point along with two support levels and two resistance levels giving a total of five levels.

The equations are as follows:

$R2 = P + (R1 - S1)$
$R1 = (P \times 2) - L$
$P = (H + L + C) / 3$
$S1 = (P \times 2) - H$
$S2 = P - (R1 - S1)$

P = Pivot point,
S = Support level
R = Resistance level
H, L and C represent the High, Low and Close respectively.

Note that limited markets such as the indices or equities simply use the High, Low and Close from the day's standard trading hours.

But the High, Low and Close for the 24-hour currency markets are often calculated using 00:00 GMT as closing time on a 24-hour cycle.

Since the Forex market is a 24-hour market with no close or open from day to day, there is often confusion on the time that should be taken for the Open, High, Low and Close from each session. Traders in different time zones can use different timing, but it is generally accepted that the time producing the most accurate levels is taking the open at 00:00 GMT with the close at 23:59 GMT.

Besides the 5-point calculation, there are some other calculations that can be used for Pivot levels. We will take a brief look at some of them, as they are also quite effective.

These calculations yield additional support and resistance levels to the basic calculation. Price action, especially in the currency markets, respects these support and resistance levels quite frequently, which makes them very helpful after a large range day when the basic support and resistance levels are far apart.

The calculations are as follows

$R2 = P + (R1 - S1)$
$M4 = (R1 + R2) / 2$
$R1 = (P \times 2) - L$
$M3 = (P + R1) / 2$
$P = (H + L + C) / 3$
$M2 = (S1 + P) / 2$
$S1 = (P \times 2) - H$
$M1 = (S2 + S1) / 2$
$S2 = P - (R1 - S1)$

The 'M' level calculations are the most useful as indications for the range of the day.

Tom DeMark, a famous technical analyst and president of Market Studies, Inc. developed another Pivot Point System using the following rules.

Using these calculations for the projected Demark High / Low, we observe that these projected levels coincide with the mid levels M1 to M4 calculated in the previous section.

This further reinforces the expectation that in whatever way the calculations are performed, price will respect these levels.

So what do these numbers tell us and how do we use them for trading the price action?

In its basic interpretation, we can say that if the market breaks the Pivot level to the upside, the sentiment is said to be a bullish and the market is likely to continue its way up. On the other hand, if the market breaks this level to the downside, the sentiment is bearish and the market is expected to continue its way down.

Also at this level, the market is expected to have some kind of support/resistance. If price cannot break through the Pivot Point level, a possible bounce from it is plausible. The Pivot Point can be used as a predictive indicator. If the following day's market price falls below the Pivot Point, it may be used as a new resistance level. Conversely, if the market price rises above the Pivot Point, it may act as the new support level.

It must be noted that Pivot Points are short-term trend indicators and are useful for only one day until they need to be recalculated. Thus, this condition is likely to sustain only until the next session.

The second method is to use the different Pivot levels to enter and exit the markets. For example, a trader might put in a limit order to enter a long position if the price breaks a resistance level and use a lower support level as a stop.

The Pivot Point/resistance levels/support levels/M levels clearly distinguish support and resistance levels. Ideally, one should take trades only when price approaches the support or resistance area. If price is moving lower and closer to support, long trades should be considered if the support level holds. Similarly, if price is moving higher towards the resistance level, short trades should be considered when this resistance holds.

The strength of support and resistance levels is usually determined by the number of times price has reacted to a particular level. The more times that price has reached a support or resistance level and reversed from there, the more powerful the level.

These levels also provide ideal technical levels to place protective stops, which can be placed just outside a support or resistance level. For example, if a short position is established when a resistance level holds, the protective stop should be placed just above the resistance level.

On the other hand, if these levels of significant support and resistance are penetrated convincingly, it signals continued price movement in the same direction as the direction of penetration.

Other Pivot Ideas/Trading Tips

Look to buy pullbacks to Pivot Point levels or sell rallies to Pivot Point levels in the direction of the prevailing trend.

Ideally, one should wait for the market to penetrate a Pivot level, moving up at least halfway to the next Pivot level and buying the first retracement back to the first violated Pivot level.

We have been calculating the Pivot Point using information of the previous session. This gives us the possible intraday resistance and support levels. Support and resistance levels can also be calculated using the previous weekly or monthly data to determine such levels. Using this method of calculation, we are able to see the market sentiment over longer periods of time. We can also see possible levels that might offer support and resistance throughout the week or month.

Calculating weekly or monthly Pivot Points is used primarily by longer-term traders; the method can also be used by short-term traders since it provides a good idea about the longer-term trend.

A very important point to be noted – the best trend days trading the Pivot levels usually take place when price opens near its Pivot Point.

In the case of currencies, the majors such as the EUR, GBP, JPY and CHF usually begin trading at their daily Pivot 2 or 3 days a week. These are the days to look for a big trend to unfold.

If the currency opens at the extremes far from the Pivot, below S2 or above R2 - it usually spends the rest of the session gyrating around that level.

At a situation like this, I would rather stay away from trading.

The most important point to remember when applying Pivot Points to day trading is to follow the trend of the day and simply look to enter into an unfolding trend as the price makes its way through Pivot values.

The Momentum Value Indicator

This is a proprietary indicator developed by FxInstructor. It is based on certain calculations of the high, low and close and the momentum values of the previous 5 days. It is developed as an indicator with histogram bars and gives an excellent reference for the trend of the day, when used along with the mid Pivot 'M' levels.

It is interpreted in the following way – If today's MV indicator Histogram is showing blue bars, then it indicates an up trending day. Hence, we have a handy reference map for the expected range based on the M values.

If today's MV indicator Histogram is showing red bars, then it indicates a down trending day. A non-trending day or a mixed day occurs when today's MV Histogram is flat or is not showing any bars.

Along with the Momentum Value Indicator, the Pivot levels are plotted directly on the charts, providing an effective map for the relevant time frame.

Money Management.

Trading is a business that requires a lot of effort, patience and discipline…just like any other business…only more.

Getting some profitable trades is not very difficult, but achieving winning trades consistently is the key to successful trading.

The Pivot Point technique has a high success ratio and gives a consistent profit curve if followed according to the rules. This does not mean that there will be no losses…there will be.

The basic money management rule is to keep your profits larger that your losses.

Remember the traders golden rule? "Let your profits run, and cut your losses"

With the Pivots technique, you can control the trades to achieve this principle since the rules allow you to do so.

As a result, this becomes one of the most simple and successful trading techniques suitable for new as well as professional traders.

Trading Examples –

Enclosed are 3 charts of the EUR/JPY, which show the Pivot Point levels across different timeframes.

Since the FxInstructor Pivot indicator is very versatile, it can automatically plot the monthly, weekly and daily pivots levels, yielding an excellent 'Top-Down' approach for analyzing the currency.

Chart.1 – daily pivots

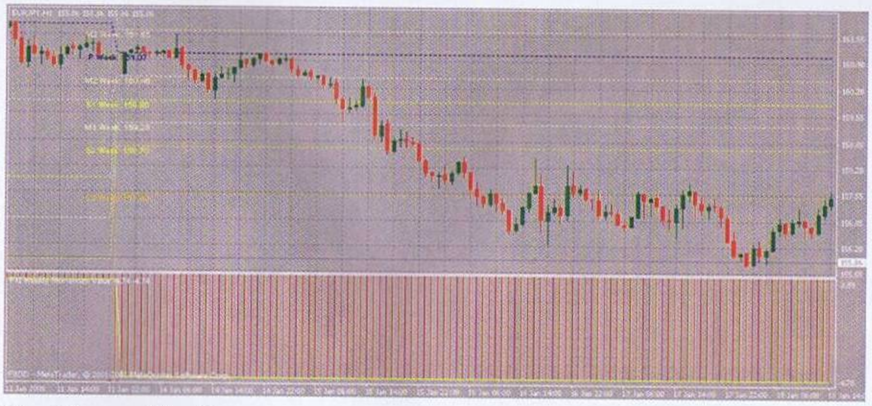

Chart.2 – weekly pivots

Chart.3 – monthly pivots

The following observations can be made from these charts –

1. Price respects the daily, weekly and monthly pivots levels, as we can note the reaction of price at almost every pivot level on each timeframe.

2. We can stay with the trend as it is clearly defined on a larger timeframe and also identify the relevant levels of resistance and support from the higher timeframes.

__Sunil Mangwani__ is a Physics graduate with a Diploma in Financial Management. He has been trading the Forex market for the last 5 years and devises simple trading strategies based on his vast knowledge and in-depth study in the field of technical analysis.

He has worked as content provider and article writer with different websites such as www.surefire-trading.com www.trading-strategies.info and www.guppytraders.com

He has also developed video modules on specialized topics and has contributed technical articles to Traders Magazine. The realization that it is essential for every trader to have proper education and mentoring, led to a desire to create such a community for other traders. Thus, the FX Instructor project was born with an aim to share his extensive knowledge of successful trading with others and to coach individuals who want to make a change in their trading methods.

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